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The Terrorism Risk Insurance Program Reauthorization Act and US-Domiciled Captives

MARSH & McLENNAN COMPANIES

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Securing adequate terrorism insurance capacity for US-based risks can be difficult, especially for nuclear, biological, chemical and radiological (NBCR) exposures. Many businesses with significant terrorism risk have found the inclusion of US domiciled captives as covered insurers under the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) gives them access to a federally funded "backstop," supporting the insurance industry in the event of certain terrorist acts. Careful planning allows these captive owners the ability to access the capacity that they need, while reducing the cost of procuring it.

Congress authorized a seven-year extension of TRIPRA in advance of its expiration at the end of 2020. The original bill, passed in 2002 in response to the insurance market shortages stemming from the September 11, 2001, attacks was designed to provide government backed reinsurance for commercial property/casualty losses resulting from certified acts of terrorism that occur in the US and its possessions. These provisions only apply to primary insurance; reinsurance transactions are excluded.

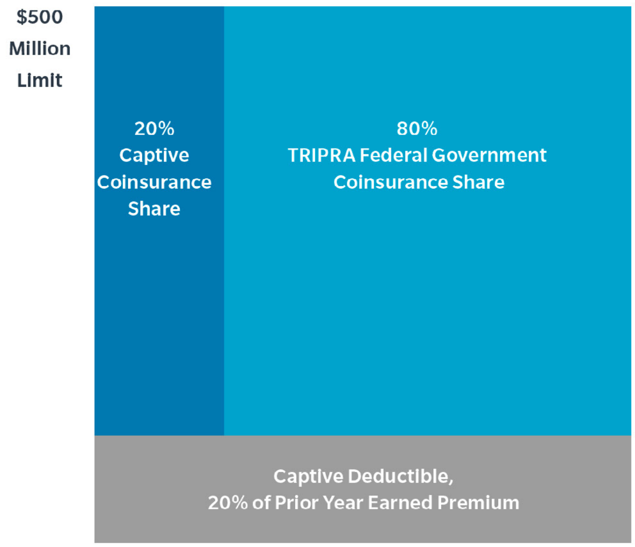
The Captive Advantage

The provisions of TRIPRA apply to captives domiciled in a US state or territory. Access to the reinsurance backstop has specific advantages for captive owners including:

- Premium savings – In the event there has been no certified terrorism event during the policy period, premiums paid to the captive are not lost to unrelated parties.
- Improved capacity – Where commercial terrorism capacity is limited, such as in high density metropolitan areas, captives can provide additional capacity through direct access to federal reinsurance.
- More commercial options – Commercial insurers provide a variety of products designed to reduce or eliminate deductibles and co-pays.
- Broader coverage – Captives can offer broader terms for coverage that are often restricted or unavailable from commercial insurers such as:
  - NBCR exposures.
  - Cyber risks.
  - Contingent time element losses.
- Flexible policy wording – Captive domiciles generally permit greater customization for policy wording.
- Coverage certainty – In each of the four reauthorization bills, the government has refined and updated the process and timetable that must be followed when determining if it will certify an attack as an act of terrorism.

Captive Financial Value — Terrorism Risk

Illustration of TRIPRA Coverage — Assumes US$500 Million Insured Terrorism Loss and Prior Year Direct Earned Premium $3,000,000



Captive Deductible	**$600,000**
Subtotal	$499,400,000
20% Quota Share	**$99,880,000**
Government Share	**$399,520,000**
Captive Share	**$100,480,000**

How the Backstop Works

Certified Terrorist Event

Should a terrorist event occur, the federal government will make a determination as to whether or not it is a certified terrorist event. Once certified, the federal government's participation is then contingent upon a loss prequalification that requires that the aggregate insured loss across all impacted insurers exceeds a threshold known as the trigger. Combined insured losses related to a specific event must exceed US$200 million before the backstop applies. The government will participate in the loss only for an event that is both certified and meets the trigger threshold.

Program Deductibles

Once an event is certified, primary insurers are required to absorb a deductible equal to 20% of the captive's prior year net earned property/casualty premium.[1]

Risk Sharing

For certified event losses that exceed the deductible, the federal reinsurance backstop will reimburse the captive 80% of its insured losses. The remaining co-pay of 20% is the responsibility of the captive unless some or all of the co-pay and/or deductible amount is commercially reinsured.

[1] For a newly created captive, the deductible is calculated on its first year's earned premium.

Other Considerations

Utilizing a US-domiciled captive in conjunction with the backstop provisions of TRIPRA can provide businesses with terrorism coverage that is more broadly based, accessible, and economical than the commercial markets alone can provide. When considering a terrorism program for a captive, there are additional factors to be considered. For example:

- Careful analysis of risks and appropriate pricing of premium is important to prevent an artificial reduction in captive retentions.
- Not all terrorism events will be certified, resulting in no TRIPRA reinsurance benefit.
- Coordination with commercial products to minimize overall risk.
- Individual domiciles may vary significantly in their regulation of minimum capitalization requirements for terrorism risk.
- The annual backstop is limited to US$100 billion. Should losses exceed the limit in any year, policyholders could receive reimbursement in an amount less than stated policy limits.

Marsh captive specialists work closely across practice areas on the provision of terrorism coverage solutions for its clients, providing real-time monitoring of TRIPRA developments, support during evaluations, implementation of programs, and education services. Marsh specialists have significant direct experience with key compliance requirements of TRIPRA due to TRIPRA's applicability to other lines of insurance that are widely underwritten by captives, including workers' compensation, general liability, and property programs and can provide advice and support on disclosure requirements, capital levels, and other TRIPRA considerations.

For more information on terrorism risks, TRIPRA, and captives, contact your Marsh representative or:

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